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STATE OF CALIFORNIA

CONSUMER POWER AND CONSERVATION FINANCING AUTHORITY

June 15, 2004

Paul Clanon
Director, Energy Division
California Public Utilities Commission
505 Van Ness Avenue, Room 4004
San Francisco, CA 94102-3298

Subject: **Results of Power Authority's Peaker Initiative Discussions with PG&E**

Dear Paul:

As you are aware, the California Power Authority ("CPA") has been pursuing an initiative to help increase the statewide reserve margin by adding 300 MW of cost-based peaking generation in California. The California Public Utilities Commission ("Commission"), in a January 22, 2004 decision, found that some portion of the 300 MW may represent a prudent investment for PG&E (and/or SCE) and that the long-term peaking contracts proposed by the CPA potentially represent cheaper peaking alternatives and should be considered fairly by the utilities. This letter reports on the results of our discussions with PG&E and expresses our concern that an opportunity to procure cost-effective and reliability supportive peaking generation may be lost.

Following the Commission's January 22nd procurement decision, we convened a meeting on March 4, 2004, at the Commission's offices to commence a cooperative effort with the investor owned utilities to further the Commission's determinations. This meeting was attended by CPUC staff, representatives of the three investor owned utilities, and CPA staff and representatives.

We met again with PG&E on March 24, 2004, as a follow-up to further discuss the Peaker Inititative. At this meeting we raised our concern that this potentially low cost opportunity may be lost if PG&E does not utilize the proposed projects and prices produced by the CPA's open and competitive solicitation. If PG&E opts to initiate an entirely new solicitation for peaking capacity that results in prices higher than those produced by the CPA solicitation, we are concerned that this will create a new (and more costly) benchmark, and that the CPA solicitation prices will no longer be available.

PG&E's May 3, 2004, letter to the CPA, on which Stephen St. Marie of your staff was copied and which is attached, confirms our concern. This letter indicates that PG&E does not intend to utilize either the CPA's competitive solicitation process or its results, and simply hopes that many of the projects that participated in the CPA Peaker Initiative will

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submit new offers in an as yet unspecified future PG&E solicitation process. PG&E's decision to embark in this direction may result in the loss of two specific opportunities: earlier on-line dates and the value added through CPA financing. Rather than adopting a posture of disinterest, PG&E could instead utilize the CPA's competitive solicitation process *and* its results and achieve earlier on-line dates since much work has already been done by the CPA. CPA participation in these projects would allow PG&E to access the strengths of the municipal bond market. Interest rates in the municipal market are at near historic lows. That market remains robust today—more than $60 billion of municipal bonds have been issued for electric power financing in the past four years.

For these reasons, we are concerned that PG&E's decision to embark in this direction may not be in the best interest of ratepayers.

Sincerely,

Laura R. Doll

Laura R. Doll
Chief Executive Officer

Attachment

Cc: Michael R. Peevey, President, CPUC
Geoffrey F. Brown, Commissioner, CPUC
Susan P. Kennedy, Commissioner, CPUC
Loretta M. Lynch, Commissioner, CPUC
Carl Wood, Commissioner, CPUC
Sunne Wright McPeak, Acting Chair, CPA
Philip Angelides, State Treasurer
Donald Vial, Director, CPA
Frank De Rosa, PG&E
Les Guliasi, PG&E
Stephen St. Marie, CPUC

Pacific Gas and Electric Company

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May 3, 2004

Mr. Richard Ferriera
California Power Authority
6285 Wilhoff Lane
Granite Bay, CA 95746

Dear Dick,

Thank you for the time you and Tom Flynn spent to brief Alice Harron and me on the Power Authority's 2003 Peaker Initiative. We have attached a summary of the meeting for the benefit of the parties who attended the meeting on March 4, 2004, at the California Public Utilities Commission. As the notes illustrate, The Power Authority prepared a thoughtful solicitation that was well-received by bidders. We will refer to the Power Authority's process and methodology as PG&E prepares its own procurement plans in response to the CPUC's Long-Term Plan decision.

At the meeting, you raised the question of whether PG&E believes any of the Peaker bids constitute a fleeting opportunity to acquire generating resources at a below-market cost. We have considered this question since our meeting, and have reviewed these projects alongside other market measures. We also have contemplated the peaker bids in the context of the Commission's long-term planning directives to develop an optimized, *least-cost portfolio through an integrated resource planning process.*

Given the market conditions and the integrated planning process the company has embarked upon, we do not believe it is in the best interest of ratepayers, or other potential generators, to select particular plants with specific operating characteristics outside of a comprehensive portfolio assessment and without unequivocal economic superiority. There are many projects in operation or in various stages of development eager to sell power. We have embarked upon an integrated process to select the most competitive power that best fits our ratepayer portfolio. We hope and expect that many of the projects that participated in the Peaker Initiative will offer their power in PG&E's process.

Sincerely,

Frank De Rosa

Frank De Rosa
Director, Power Contracts

cc: Stephen St. Marie -- California Public Utilities Commission
Thomas Flynn -- California Power Authority
Roy Kuga -- Pacific Gas and Electric Company
Les Guliasi -- Pacific Gas and Electric Company
Alice Harron -- Pacific Gas and Electric Company

Meeting Summary 3/24/04
California Consumer Power and Financing Authority (CPA)
and Pacific Gas and Electric (PG&E).

Attendees: Thomas Flynn (CPA), Richard Ferreira (Energy Consulting Services) collectively (CPA); Frank DeRosa (Pacific Gas and Electric), Alice Harron (Pacific Gas and Electric, collectively (PG&E)

Summary

The purpose of the meeting was to review the Request for Offer Process that the CPA had used in its solicitation of peaker projects. CPA reviewed the process along with the results.

Overall Bidding Process

CPA reviewed the bidding process. CPA held pre-bid conference and asked for attendees to submit notice for intent to respond to bid. CPA looked at existing plant sites that could expand as well as asked CAISO for preferred locations for PG&E service territory. CPA asked for plants with less than 12,000 Btu/kWh LHV (i.e., approximately 13,300 HHV) and could dispatch either 2,000 or up to 4,000 hours per year. Plants would also need a 10 minute quick start capability.

During the review process, the CPA conducted a preliminary due diligence. CPA reviewed, among other issues:

- site parcels status (e.g., options or ownership);
- participants' development and construction experience;
- transmission/substation access (however, due to time, interconnection studies were not performed; CPA asked for developers' best estimate); and
- credit worthiness (including litigation and credit rating).

The CPA did not have a Power Purchase Agreement or Developer Agreement as part of the RFP. The PPA needed to be with the IOU.

Bid Requirement and Evaluation Criteria

Bids included separate O&M bids, fixed administration costs, and a management fee. While the participant submitted a forecasted O&M budget, the actual O&M budget would be agreed to every year. Plants could also submit bids that omitted property taxes. This item would be negotiated later.

CPA noted that multiple technologies bid. While the majority of the plants were based on LM6000, some bidders submitted recip plants.

CPA stated that there was a first phase pass/fail Criteria. The bids must have met all of these criteria to proceed to the next cut.

	Category 1	Category 2
Turnkey Price	55-65	55-65
On-line date	0-20	0-20
Correlation with Needs	0-15	0-15

Turnkey price relates to the $500/kW for Category 1 and lower relative costs for Category 2. CPA assumes that plants built in congested areas would pay more than $500/kW.

The earlier the on-line date the higher points scored. The plant coming on-line prior to 5/15/05 scores higher than those coming on line between 5/15/05 and 8/15/05. The correlation with needs was more qualitative.

After scoring, the projects fell into three categories:

Tier A – projects that are recommended to go forward with IOUs.
Tier B – good projects but not as good as Tier A
Tier C – projects that are not recommended to go forward

CPA thought that the projects, with the exception of Chula Vista, have not made any further progress since the initial bids. San Diego Gas & Electric selected the Chula Vista project in its recent procurement RFP.